The Price of Risk

How insurers connect risk, possible losses, and premiums

SS.8.FL.6.5 "Discuss that insurance companies charge higher premiums to cover higher-risk individuals and events because the risk of monetary loss is greater for these individuals and events."

NAME ______________________________ DATE ______________

1 READ AND MARK

Read it twice

YOUR JOB Underline each higher-risk individual, property, or event. Circle the words or sentence parts that explain why its premium is higher, then number the three examples 1 through 3.

Why Risk Changes the Price

1 Insurance helps people pay for certain losses, such as damage from a crash or a fire. Customers pay a premium, the amount charged for coverage. Before setting that price, an insurance company estimates how likely a loss is and how costly it could be. The company uses information about the person, property, or event being insured. It is not predicting that a loss will happen. It is estimating the chance that money may be needed to cover one.

2 For auto insurance, a driver with several recent at-fault crashes may be charged a higher premium than a driver with a safe record. The first driver presents a greater chance that the insurer will need to pay for another claim. A home near a river that often floods can also cost more to insure than a similar home in a lower-risk location. In both cases, the expected monetary loss is greater, so the company charges more to help cover that risk.

3 Risk also changes for events. An outdoor concert scheduled during a season of frequent severe storms may have a higher premium for cancellation coverage than a similar concert held during a calmer season. A cancellation could require refunds, lost ticket income, or extra expenses. Premiums collected from many customers help an insurer pay covered claims. When expected losses rise for a group or event, charging higher premiums helps the company have enough money to meet those possible claims.

2 ANSWER WITH EVIDENCE

Use the passage

1. What two things does an insurance company estimate before setting a premium?

2. Why might the driver with several recent at-fault crashes pay a higher premium than the driver with a safe record?

3. How does a home near a frequently flooding river show the connection between risk and premium?

4. Why could cancellation coverage cost more for an outdoor concert during a season of frequent severe storms?

3 YOUR TURN

Your own words

Choose a type of insurance not named in the passage. In three sentences, compare a lower-risk and higher-risk person, property, or event, state which would have a higher premium, and explain how the greater chance or cost of a monetary loss leads to that price.

PART 1 · READ AND MARK

Underline each higher-risk individual, property, or event. Circle the words or sentence parts that explain why its premium is higher, then number the three examples 1 through 3. Accept any marking that follows this job and points at the right text.

PART 2 · ANSWERS

#	QUESTION	ANSWER
1	What two things does an insurance company estimate before setting a premium?	**The company estimates how likely a loss is and how costly the loss could be.**
2	Why might the driver with several recent at-fault crashes pay a higher premium than the driver with a safe record?	**The driver with crashes has a greater chance of another claim, so the insurer may have to pay more money.**
3	How does a home near a frequently flooding river show the connection between risk and premium?	**The home has a greater risk of flood damage than a similar home in a lower-risk location. The expected monetary loss is greater, so its premium can be higher.**
4	Why could cancellation coverage cost more for an outdoor concert during a season of frequent severe storms?	**Storms make cancellation more likely. A cancellation could lead to refunds, lost ticket income, or extra expenses, so the possible monetary loss is greater.**

PART 3 · YOUR TURN (SAMPLE ANSWER)

Two boat owners buy coverage for theft and damage. Sam stores a boat in a locked garage, while Lee leaves a similar boat at an unsecured dock in an area with frequent storms. Lee would likely pay a higher premium because theft or storm damage is more likely, creating a greater possible monetary loss for the insurer.

Accept equivalent explanations that connect a higher chance or greater cost of a covered loss to a higher premium. For Part 3, accept varied examples if the comparison clearly identifies the higher-risk case and accurately explains the premium difference.